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**SUBJECT:** POTENTIAL TAX IMPACT OF RETAIL LOAD CHANGES

As you know, the Comprehensive Review and other future changes in the nation's retail electricity delivery system have the potential to affect Washington's tax revenues. Revenues from non-federal (i.e., non-Bonneville Power Association [BPA]) electricity sales in the state are currently subject to the public utilities tax, at the rate of 3.87 percent of gross revenues. Because BPA is a federal entity, its retail power sales are not subject to the state public utilities tax. In addition to state taxes, cities obtain up to eight percent of revenues from local public utilities taxes.

Public utilities tax revenues could be affected by industry changes in two ways. If companies which currently purchase electricity directly from BPA (the "Direct Service Industries [DSI]) begin to purchase some or all of their power from public utilities, these purchases would be subject to the public utilities tax and would result in an increase in state tax revenues. Prior estimates by WSEO indicate that, if the DSIs purchase 20 percent of their electricity from a local utility, state public utilities tax revenues would increase by \$2-3 million.

If, however, the state's public utilities lost half of their large industrial customers to power marketers, state public utilities tax revenues could decline by as much as \$8 million. Entities with no "nexus", or presence, in Washington State cannot be taxed. Industrial customers might therefore choose to purchase power from an out-of-state utility or power marketer in order to escape the public utilities tax. Since margins on market power sales are very small, tax avoidance is a clear opportunity, perhaps the only opportunity, for power marketers to increase their profit.

These are reasonable estimates based on activities which are likely to result from changes proposed during the Comprehensive Review. More radical changes might result in the privatization of BPA, which could result in additional tax revenues of \$13 million, or the establishment of a competitive retail market dominated by out-of-state companies (similar to the competition between AT&T, MCI, and Sprint in telecommunications). If half of all energy services were exempt from the public utility tax, the resultant loss in state tax revenues could exceed \$50 million.

At this point, it is unclear whether out-of-state power brokers would be subject to taxation under the public utilities tax. The statute (RCW 82.16.010) states that:

'Light and power business' means the business of operating a plant or system for the generation, production, or distribution of electrical energy for hire or sale and/or for the wheeling of electricity to others.

The Department of Revenue believes that a broker could easily do business with instate customers from a location out of the state and thus not have taxable nexus on the sale of electricity to customers. And under very similar circumstances in the gas industry, the legislature apparently felt the question was ambiguous enough to warrant an amendment to the RCWs to deal with brokered gas transactions.

The attached tables present all known potential or actual load changes which might have an impact on Washington tax revenues. Also attached is a partial list of utilities which plan to offer "market rates" to large industrial customers. These are included because of the potential for power generators and customers to agree to "skip the middleman" (i.e., the distribution utility) and make direct deals.

Please call either Deb Ross at (360) 956-2124, or myself at (360) 956-2124, if you have any further questions regarding this issue.

Attachment(s)